

SERVICE CORPORATION INTERNATIONAL

Form 10-Q

October 30, 2014

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended September 30, 2014

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the transition period from to

Commission file number 1-6402-1

SERVICE CORPORATION INTERNATIONAL

(Exact name of registrant as specified in its charter)

Texas

(State or other jurisdiction of incorporation or
organization)

74-1488375

(I. R. S. employer identification number)

1929 Allen Parkway, Houston, Texas

(Address of principal executive offices)

77019

(Zip code)

713-522-5141

(Registrant's telephone number, including area code)

None

(Former name, former address, or former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting
company

(Do not check if smaller reporting
company)

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

YES NO

The number of shares outstanding of the registrant's common stock as of October 28, 2014 was 207,643,698 (net of treasury shares).

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GLOSSARY

The following terms are common to the deathcare industry, are used throughout this report, and have the following meanings:

Atneed — Funeral and cemetery arrangements sold after a death has occurred.

Burial Vault — A reinforced container intended to inhibit the subsidence of the earth and house the casket after it is placed in the ground.

Cemetery Perpetual Care or Endowment Care Fund — A trust fund established for the purpose of maintaining cemetery grounds and property into perpetuity.

Cemetery Property — Developed lots, lawn crypts, and mausoleum spaces and undeveloped land we intend to develop.

Cemetery Property Revenue — Recognized sales of cemetery property when a minimum of 10% of the sales price has been collected and the property has been constructed or is available for interment.

Cemetery Merchandise and Services — Stone and bronze memorials, markers, merchandise installations, and burial openings and closings.

Cremation — The reduction of human remains to bone fragments by intense heat.

Funeral Merchandise and Services — Professional services relating to funerals and cremations and funeral-related merchandise, including caskets, casket memorialization products, burial vaults, cremation receptacles, cremation memorial products, and flowers.

Funeral Recognized Preneed Revenue — Funeral merchandise and travel protection sold on a preneed contract and delivered before a death has occurred.

Funeral Services Performed — The number of funeral services provided after the date of death, sometimes referred to as funeral volume.

General Agency (GA) Revenues — Commissions we receive from third-party life insurance companies for life insurance policies or annuities sold to preneed customers for the purpose of funding preneed funeral arrangements. The commission rate paid is determined based on the product type sold, the length of payment terms, and the age of the insured/annuitant.

Interment — The burial or final placement of human remains in the ground, in mausoleums, or in cremation niches.

Lawn Crypt — An underground outer burial receptacle constructed of concrete and reinforced steel, which is usually pre-installed in predetermined designated areas.

Marker — A method of identifying a deceased person in a particular burial space, crypt, or niche. Permanent burial markers are usually made of bronze or stone.

Maturity — When the underlying contracted service is performed or merchandise is delivered, typically at death. This is the point at which preneed contracts are converted to atneed contracts (note — delivery of certain merchandise and products can occur prior to death).

Mausoleum — An above ground structure that is designed to house caskets and cremation urns.

Preneed — Purchase of products and services prior to a death occurring.

Preneed Backlog — Future revenues from unfulfilled preneed funeral and cemetery contractual arrangements.

Preneed Cemetery Production — Sales of preneed or atneed cemetery contracts. These earnings are recorded in Deferred preneed cemetery revenues until the service is performed, the merchandise is delivered, or when a minimum of 10% of the sales price has been collected and the property has been constructed or is available for interment.

Preneed Funeral Production — Sales of preneed funeral trust-funded and insurance-funded contracts. Preneed funeral trust-funded contracts are recorded in Deferred preneed funeral revenues until the service is performed or the merchandise is delivered. We do not reflect the unfulfilled insurance-funded preneed funeral contract amounts in our consolidated balance sheet. The proceeds of the life insurance policies or annuity contracts will be reflected in funeral revenues when these funerals are performed by the Company.

Sales Average — Average revenue per funeral service performed, excluding the impact of funeral recognized preneed revenue, GA revenue, and certain other revenues.

Trust Fund Income — Recognized earnings from our merchandise and service and perpetual care trust investments.

As used herein, “SCI”, “Company”, “we”, “our”, and “us” refer to Service Corporation International and companies owned directly or indirectly by Service Corporation International, unless the context requires otherwise.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands, except per share amounts)			
Revenues	\$718,314	\$608,589	\$2,210,569	\$1,883,238
Costs and expenses	(570,016)	(492,784)	(1,740,167)	(1,482,123)
Gross profits	148,298	115,805	470,402	401,115
General and administrative expenses	(39,748)	(33,740)	(141,885)	(96,042)
Gains (losses) on divestitures and impairment charges, net	26,570	981	58,752	(5,533)
Operating income	135,120	83,046	387,269	299,540
Interest expense	(43,376)	(38,080)	(134,679)	(103,589)
(Losses) gains on early extinguishment of debt	—	—	(29,158)	468
Other (expense) income, net	(9)	667	1,577	(1,013)
Income before income taxes	91,735	45,633	225,009	195,406
Provision for income taxes	(74,934)	(18,407)	(134,998)	(75,295)
Net income from continuing operations	16,801	27,226	90,011	120,111
Net income from discontinued operations, net of tax	884	168	846	441
Net income	17,685	27,394	90,857	120,552
Net income attributable to noncontrolling interests	(34)	(615)	(6,182)	(2,537)
Net income attributable to common stockholders	\$17,651	\$26,779	\$84,675	\$118,015
Basic earnings per share:				
Net income attributable to common stockholders	\$0.08	\$0.13	\$0.40	\$0.56
Basic weighted average number of shares	210,820	211,954	212,009	211,721
Diluted earnings per share:				
Net income attributable to common stockholders	\$0.08	\$0.12	\$0.39	\$0.55
Diluted weighted average number of shares	213,010	216,370	215,365	215,877
Dividends declared per share	\$0.09	\$0.07	\$0.25	\$0.20

(See notes to unaudited condensed consolidated financial statements)

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SERVICE CORPORATION INTERNATIONAL
 CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
 (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Net income	\$17,685	\$27,394	\$90,857	\$120,552
Other comprehensive income:				
Foreign currency translation adjustments	(16,060)	7,497	(13,732)	(9,773)
Reclassification of foreign currency translation adjustments to discontinued operations	3,114	—	3,114	—
Total comprehensive income	4,739	34,891	80,239	110,779
Total comprehensive income attributable to noncontrolling interests	(24)	(620)	(6,182)	(2,532)
Total comprehensive income attributable to common stockholders	\$4,715	\$34,271	\$74,057	\$108,247

(See notes to unaudited condensed consolidated financial statements)

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CONDENSED CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	September 30, 2014	December 31, 2013
	(In thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$266,259	\$ 141,599
Receivables, net	92,719	102,198
Deferred tax assets	28,369	27,138
Inventories	32,471	34,145
Current assets of discontinued operations	—	4,750
Current assets held for sale	436	4,569
Other	47,445	65,574
Total current assets	467,699	379,973
Preneed funeral receivables, net and trust investments	1,876,272	1,888,271
Preneed cemetery receivables, net and trust investments	2,337,392	2,277,362
Cemetery property, at cost	1,739,933	1,768,595
Property and equipment, net	1,872,162	1,923,086
Non-current assets of discontinued operations	—	2,491
Non-current assets held for sale	136,897	827,598
Goodwill	1,898,885	1,888,772
Deferred charges and other assets	619,442	618,708
Cemetery perpetual care trust investments	1,381,549	1,339,842
Total assets	\$ 12,330,231	\$ 12,914,698
LIABILITIES & EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$460,364	\$483,601
Current maturities of long-term debt	109,266	176,362
Current liabilities of discontinued operations	—	4,728
Current liabilities held for sale	441	3,183
Income taxes	15,707	6,456
Total current liabilities	585,778	674,330
Long-term debt	2,958,500	3,125,548
Deferred preneed funeral revenues	526,287	521,845
Deferred preneed cemetery revenues	1,087,241	1,043,460
Deferred tax liability	620,098	575,978
Non-current liabilities of discontinued operations	—	968
Non-current liabilities held for sale	141,490	518,371
Other liabilities	430,731	445,934
Deferred preneed funeral and cemetery receipts held in trust	3,234,074	3,245,705
Care trusts' corpus	1,380,096	1,338,181
Commitments and contingencies (Note 15)		
Equity:		
Common stock, \$1 per share par value, 500,000,000 shares authorized, 215,585,410 and 212,326,642 shares issued, respectively, and 209,230,875 and 212,316,642 shares outstanding, respectively	209,231	212,317

Capital in excess of par value	1,218,332	1,259,348
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Accumulated deficit	(148,085)	(145,876)
Accumulated other comprehensive income	77,823		88,441	
Total common stockholders' equity	1,357,301		1,414,230	
Noncontrolling interests	8,635		10,148	
Total equity	1,365,936		1,424,378	
Total liabilities and equity	\$ 12,330,231		\$ 12,914,698	

(See notes to unaudited condensed consolidated financial statements)

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CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended	
	September 30,	
	2014	2013
	(In thousands)	
Cash flows from operating activities:		
Net income	\$90,857	\$120,552
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations, net of tax	(846)	(441)
Losses (gains) on early extinguishment of debt	29,158	(468)
Premiums paid on early extinguishment of debt	(24,804)	—
Depreciation and amortization	105,098	91,691
Amortization of intangible assets	27,792	16,619
Amortization of cemetery property	41,477	32,036
Amortization of loan costs	6,436	3,997
Provision for doubtful accounts	6,142	5,238
Provision for deferred income taxes	59,614	55,784
(Gains) losses on divestitures and impairment charges, net	(58,752)	5,533
Share-based compensation	9,742	8,887
Excess tax benefits from share-based awards	(20,727)	(6,083)
Change in assets and liabilities, net of effects from acquisitions and divestitures:		
(Increase) decrease in receivables	(7,038)	14,092
Increase in other assets	(12,845)	(14,672)
Increase in payables and other liabilities	38,439	24,674
Effect of preneed funeral production and maturities:		
Decrease in preneed funeral receivables, net and trust investments	29,498	33,157
Decrease in deferred preneed funeral revenue	(24,746)	(9,769)
Decrease in deferred preneed funeral receipts held in trust	(29,879)	(34,026)
Effect of cemetery production and deliveries:		
Increase in preneed cemetery receivables, net and trust investments	(37,559)	(49,500)
Increase in deferred preneed cemetery revenue	34,388	36,183
Decrease in deferred preneed cemetery receipts held in trust	(5,355)	(8,051)
Other	1,131	298
Net cash provided by operating activities from continuing operations	257,221	325,731
Net cash (used in) provided by operating activities from discontinued operations	(1,000)	703
Net cash provided by operating activities	256,221	326,434
Cash flows from investing activities:		
Capital expenditures	(95,182)	(79,539)
Acquisitions, net of cash received	(10,815)	(8,543)
Proceeds from divestitures and sales of property and equipment	397,297	10,077
Net (deposits) withdrawals of restricted funds	(12,225)	341
Net cash provided by (used in) investing activities from continuing operations	279,075	(77,664)
Net cash provided by (used in) investing activities from discontinued operations	4,981	(111)
Net cash provided by (used in) investing activities	284,056	(77,775)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	755,000	—

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Debt issuance costs	(10,500)	—)
Payments of debt	(222,958)	(90,435)
Early extinguishment of debt	(762,764)	—)
Principal payments on capital leases	(21,979)	(19,585)
Proceeds from exercise of stock options	27,609		4,954	
Excess tax benefits from share-based awards	20,727		6,083	
Purchase of Company common stock	(130,162)	(1,708)
Payments of dividends	(53,026)	(42,371)
Purchase of noncontrolling interest	(15,000)	(8,333)
Bank overdrafts and other	(3,377)	(5,479)

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	Nine Months Ended	
	September 30,	
	2014	2013
Net cash used in financing activities from continuing operations	(416,430)	(156,874)
Net cash used in financing activities from discontinued operations	—	(1,359)
Net cash used in financing activities	(416,430)	(158,233)
Net change in cash of discontinued operations	1,361	767
Effect of foreign currency on cash and cash equivalents	(548)	(613)
Net increase in cash and cash equivalents	124,660	90,580
Cash and cash equivalents at beginning of period	141,599	88,769
Cash and cash equivalents at end of period	\$266,259	\$179,349

(See notes to unaudited condensed consolidated financial statements)

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SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF EQUITY
(UNAUDITED)
(In thousands)

	Common Stock	Treasury Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total
Balance at December 31, 2012	\$211,057	\$(10)	\$1,307,058	\$(286,795)	\$ 111,717	\$ 19,800	\$1,362,827
Comprehensive income	—	—	—	118,015	(9,768)	2,532	110,779
Dividends declared on common stock (\$.20 per share)	—	—	(42,371)	—	—	—	(42,371)
Employee share-based compensation earned	—	—	8,887	—	—	—	8,887
Stock option exercises	573	—	4,524	—	—	—	5,097
Restricted stock awards, net of forfeitures	378	(3)	(375)	—	—	—	—
Purchase of Company common stock	—	(117)	(717)	(1,017)	—	—	(1,851)
Cancellation of Company stock	(8)	8	—	—	—	—	—
Tax benefits related to share-based awards	—	—	6,083	—	—	—	6,083
Purchase of noncontrolling interest	—	—	(1,696)	—	—	(6,637)	(8,333)
Noncontrolling interest payment	—	—	—	—	—	(1,700)	(1,700)
Other	82	—	1,274	—	—	—	1,356
Balance at September 30, 2013	\$212,082	\$(122)	\$1,282,667	\$(169,797)	\$ 101,949	\$ 13,995	\$1,440,774
Balance at December 31, 2013	212,327	(10)	1,259,348	(145,876)	88,441	10,148	1,424,378
Comprehensive income	—	—	—	84,675	(10,618)	6,182	80,239
Dividends declared on common stock (\$.25 per share)	—	—	(53,026)	—	—	—	(53,026)
Employee share-based compensation earned	—	—	9,742	—	—	—	9,742
Stock option exercises	2,855	—	25,515	—	—	—	28,370
Restricted stock awards, net of forfeitures	352	—	(352)	—	—	—	—
	—	(6,386)	(37,653)	(86,884)	—	—	(130,923)

Purchase of Company common stock							
Cancellation of Company Stock	(42)	42	—	—	—	—
Tax benefits related to share-based awards	—	—	20,727	—	—	—	20,727
Purchase of noncontrolling interest	—	—	(7,440)	—	—	(7,560) (15,000)
Noncontrolling interest payment	—	—	—	—	—	(135) (135)
Other	93	—	1,471	—	—	—	1,564
Balance at September 30, 2014	\$215,585	\$(6,354)	\$1,218,332	\$(148,085)	\$ 77,823	\$ 8,635	\$1,365,936

(See notes to unaudited condensed consolidated financial statements)

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SERVICE CORPORATION INTERNATIONAL

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share amounts)

1. Nature of Operations

We are North America's largest provider of deathcare products and services, with a network of funeral service locations and cemeteries operating in the United States and Canada. Our operations consist of funeral service locations, cemeteries, funeral service/cemetery combination locations, crematoria, and related businesses. Funeral service locations provide all professional services relating to funerals and cremations, including the use of funeral facilities and motor vehicles and preparation and embalming services. Funeral-related merchandise, including caskets, casket memorialization products, burial vaults, cremation receptacles, cremation memorial products, flowers, and other ancillary products and services, is sold at funeral service locations. Cemeteries provide cemetery property interment rights, including developed lots, lawn crypts, and mausoleum spaces and sell cemetery-related merchandise and services, including stone and bronze memorials, markers, merchandise installations, and burial openings and closings. We also sell preneed funeral and cemetery merchandise and services whereby a customer contractually agrees to the terms of certain merchandise and services to be provided in the future.

2. Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

Our unaudited condensed consolidated financial statements include the accounts of Service Corporation International (SCI) and all subsidiaries in which we hold a controlling financial interest. Our financial statements also include the accounts of the funeral merchandise and service trusts, cemetery merchandise and service trusts, and cemetery perpetual care trusts in which we have a variable interest and are the primary beneficiary. Our interim condensed consolidated financial statements are unaudited but include all adjustments, consisting of normal recurring accruals and any other adjustments, which management considers necessary for a fair statement of our results for these periods. Our unaudited condensed consolidated financial statements have been prepared in a manner consistent with the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2013, unless otherwise disclosed herein, and should be read in conjunction therewith. The accompanying year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year period.

Reclassifications

Certain reclassifications have been made to prior period amounts to conform to the current period financial statement presentation with no effect on our previously reported results of operations, consolidated financial position, or cash flows. In this filing we revised our consolidated balance sheet as of December 31, 2013 to reclassify \$30.0 million from Long-term debt to Current maturities of long-term debt. The original misclassification relates to amounts payable in 2014 for our Term Loan due July 2018. Our previously issued December 31, 2013 financial statements are not materially misstated by this misclassification. On July 8, 2014, we sold our operations in Germany. As such, we have classified the assets and results of operations of these businesses as discontinued operations in all periods presented.

Use of Estimates in the Preparation of Financial Statements

The preparation of the unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions as described in our Annual Report on Form 10-K for the year ended December 31, 2013. These estimates and assumptions may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. As a result, actual results could differ from these estimates.

Preneed Funeral and Cemetery Receivables

We sell preneed funeral and cemetery contracts whereby the customer enters into arrangements for future merchandise and services prior to the time of need. As these contracts are entered into prior to the delivery of the related goods and

services, the preneed funeral and cemetery receivables are offset by a comparable deferred revenue amount. These receivables generally have an interest component for which interest income is recorded when the interest amount is considered collectible and realizable, which typically coincides with cash payment. We do not accrue interest on financing receivables that are not paid in accordance with the contractual payment date given the nature of our goods and services, the nature of our contracts with customers, and the timing of the delivery of our services. We do not consider receivables to be past due until the service or goods are required to be delivered at which time the preneed receivable is paid or reclassified as a trade receivable with payment terms of less than 30

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days. As the preneed funeral and cemetery receivables are offset by comparable deferred revenue amounts, we have no risk of loss related to these receivables.

If a preneed contract is canceled prior to delivery, state or provincial law governs the amount of the refund owed to the customer, if any, including the amount of the attributed investment earnings. Upon cancellation, we receive the amount of principal deposited to the trust and previously undistributed net investment earnings and, where required, issue a refund to the customer. We retain excess funds, if any, and recognize the attributed investment earnings (net of any investment earnings payable to the customer) as revenue in the consolidated statement of operations. In certain jurisdictions, we may be obligated to fund any shortfall if the amount deposited by the customers exceed the funds in trust. Based on our historical experience, we have provided an allowance for cancellation of these receivables, which is recorded as a reduction in receivables with a corresponding offset to deferred revenue.

Income Taxes

In July 2013, the Financial Accounting Standards Board (FASB) amended the Income Taxes Topic of the Accounting Standards Codification (ASC) to eliminate a diversity in practice for the presentation of unrecognized tax benefits when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendment requires that the unrecognized tax benefit be presented as a reduction of the deferred tax assets associated with the carryforwards except in certain circumstances when it would be reflected as a liability. We adopted this amendment effective January 1, 2014 with no impact on our consolidated results of operations, consolidated financial position, or cash flows.

Foreign Currency

In March 2013, the FASB amended the Foreign Currency Matters Topic of the ASC to clarify the appropriate accounting when a parent ceases to have a controlling interest in a subsidiary or group of assets that is a business within a foreign entity. This clarification provides that the cumulative translation adjustment should only be released into net income if the loss of controlling interest represents complete or substantially complete liquidation of the foreign entity in which the subsidiary or asset group had resided. We adopted this amendment effective January 1, 2014 with no impact on our consolidated results of operations, consolidated financial position, or cash flows.

3. Recently Issued Accounting Standards

Discontinued Operations

In April 2014, the FASB amended the Presentation of Financial Statements and Property, Plant, and Equipment Topics of the ASC to change the requirement for reporting discontinued operations. Under the new guidance, a disposal of a component of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. Fewer disposals are expected to qualify as discontinued operations under the new guidance. It also requires the disclosure of pretax income of disposals that do not qualify as discontinued operations. The new guidance is effective with disposals that occur after January 1, 2015.

Revenue Recognition

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers" (Topic 606), which supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition", and most industry-specific guidance. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. Additionally, the ASU requires the deferral of direct incremental selling costs to the period in which the underlying revenue is recognized. The amendments in the ASU will be applied using one of two retrospective methods. The new guidance is effective for us beginning January 1, 2017 and we are still evaluating the impact of adoption on our consolidated results of operations.

4. Preneed Funeral Activities

Preneed funeral receivables, net and trust investments represent trust investments, including investment earnings and customer receivables, net of unearned finance charges, related to unperformed, price-guaranteed preneed funeral contracts. Our funeral merchandise and service trusts are variable interest entities as defined in the Consolidation Topic of the ASC. In accordance with this guidance, we have determined that we are the primary beneficiary of these trusts, as we absorb a majority of the losses and returns associated with these trusts. The trust investments detailed in Notes 5 and 6 are also accounted for as variable interest entities. When we receive payments from the customer, we deposit the amount required by law into the trust and reclassify the

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corresponding amount from Deferred preneed funeral revenues into Deferred preneed funeral and cemetery receipts held in trust. Amounts are withdrawn from the trusts after the contract obligations are performed. Cash flows from preneed funeral contracts are presented as operating cash flows in our unaudited condensed consolidated statement of cash flows.

Preneed funeral receivables, net and trust investments are reduced by the trust investment earnings (realized and unrealized) that we have been allowed to withdraw in certain states prior to maturity. These earnings are recorded in Deferred preneed funeral revenues until the service is performed or the merchandise is delivered.

The table below sets forth certain investment-related activities associated with our preneed funeral merchandise and service trusts:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
	(In thousands)			
Deposits	\$23,618	\$20,187	\$76,490	\$63,802
Withdrawals	27,718	24,242	103,410	92,491
Purchases of available-for-sale securities	238,860	125,113	379,650	302,939
Sales of available-for-sale securities	274,630	91,064	445,880	337,714
Realized gains from sales of available-for-sale securities	18,935	12,953	50,947	41,654
Realized losses from sales of available-for-sale securities	(2,094)	(2,212)	(6,233)	(8,378)

The components of Preneed funeral receivables, net and trust investments in our unaudited condensed consolidated balance sheet at September 30, 2014 and December 31, 2013 are as follows:

	September 30, 2014	December 31, 2013
	(In thousands)	
Trust investments, at fair value	\$1,262,940	\$1,442,418
Cash and cash equivalents	172,372	128,216
Assets associated with businesses held for sale	(34,755)	(167,615)
Insurance-backed fixed income securities	263,691	280,969
Trust investments	1,664,248	1,683,988
Receivables from customers	263,685	259,801
Unearned finance charge	(10,675)	(10,179)
	1,917,258	1,933,610
Allowance for cancellation	(40,986)	(45,339)
Preneed funeral receivables, net and trust investments	\$1,876,272	\$1,888,271

Our funeral merchandise and service trust investments are recorded at fair value. The costs and fair values at September 30, 2014 and December 31, 2013 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair value represents the market value of the underlying securities held by the common trust funds, mutual funds at published values, and the estimated fair value of private equity investments (including debt as well as the estimated fair value related to the contract holder's equity in majority-owned real estate investments).

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	September 30, 2014				
	Fair Value	Cost	Unrealized	Unrealized	Fair
	Hierarchy		Gains	Losses	Value
	Level				
	(In thousands)				
Fixed income securities:					
U.S. Treasury	2	\$104,517	\$1,365	\$(53)	\$105,829
Canadian government	2	94,889	321	(922)	94,288
Corporate	2	42,598	3,001	(126)	45,473
Residential mortgage-backed	2	1,496	25	(21)	1,500
Asset-backed	2	133	2	—	135
Equity securities:					
Preferred stock	2	8,516	422	—	8,938
Common stock:					
United States	1	252,015	57,523	(126)	309,412
Canada	1	16,510	5,014	(282)	21,242
Other international	1	21,202	4,130	(2)	25,330
Mutual funds:					
Equity	1	332,092	20,198	(586)	351,704
Fixed income	1	259,964	4,651	(1,125)	263,490
Private equity	3	33,470	3,577	(7,112)	29,935
Other	3	5,204	482	(22)	5,664
Trust investments		\$1,172,606	\$100,711	\$(10,377)	\$1,262,940

	December 31, 2013				
	Fair Value	Cost	Unrealized	Unrealized	Fair
	Hierarchy		Gains	Losses	Value
	Level				
	(In thousands)				
Fixed income securities:					
U.S. Treasury	2	\$112,173	\$1,299	\$(5,599)	\$107,873
Canadian government	2	100,263	81	(1,113)	99,231
Corporate	2	64,721	3,515	(691)	67,545
Residential mortgage-backed	2	2,446	23	(33)	2,436
Asset-backed	2	3,419	—	(10)	3,409
Equity securities:					
Preferred stock	2	30,586	755	(235)	31,106
Common stock:					
United States	1	371,560	77,962	(2,928)	446,594
Canada	1	27,730	4,346	(1,217)	30,859
Other international	1	36,149	4,986	(198)	40,937
Mutual funds:					
Equity	1	261,598	22,530	(2,303)	281,825
Fixed income	1	318,257	3,228	(19,577)	301,908
Private equity	3	32,909	2,702	(8,726)	26,885
Other	3	1,552	291	(33)	1,810
Trust investments		\$1,363,363	\$121,718	\$(42,663)	\$1,442,418

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Where quoted prices are available in an active market, securities held by the common trust funds and mutual funds are classified as Level 1 investments pursuant to the three-level valuation hierarchy as required by the Fair Value Measurements and Disclosure (FVM&D) Topic of the ASC.

Where quoted market prices are not available for the specific security, fair values are estimated by using either quoted prices of securities with similar characteristics or an income approach fair value model with observable inputs that include a combination of interest rates, yield curves, credit risks, prepayment speeds, rating, and tax-exempt status. These funds are classified as Level 2 investments pursuant to the three-level valuation hierarchy as required by the FVM&D Topic of the ASC.

The valuation of private equity and other alternative investments requires management judgment due to the absence of quoted market prices, inherent lack of liquidity, and the long-term nature of such assets. The fair value of these investments is estimated based on the market value of the underlying real estate and private equity investments. The underlying real estate value is determined using the most recent available appraisals. Private equity instruments are valued based on reported net asset values discounted by 0% to 20% for risk and 0% to 10% for liquidity. A significant increase (decrease) in the discount rates results in a directionally opposite change in the fair value of the instruments. Valuation policies and procedures are determined by our Trust Services department, which reports to our Chief Financial Officer. Additionally, valuations are reviewed by the Investment Committee of the Board of Directors quarterly. These funds are classified as Level 3 investments pursuant to the three-level valuation hierarchy as required by the FVM&D Topic of the ASC.

As of September 30, 2014, our unfunded commitment for our private equity and other investments was \$26.1 million which, if called, would be funded by the assets of the trusts. Our private equity and other investments include several funds that invest in limited partnerships, distressed debt, real estate, and mezzanine financing. These investments can never be redeemed by the funds. Instead, due to the nature of the investments in this category, distributions are received through the liquidation of the underlying assets of the funds. We estimate that the underlying assets will be liquidated over the next 2 to 10 years.

The change in our market-based funeral merchandise and service trust investments with significant unobservable inputs (Level 3) is as follows:

	Three Months Ended		September 30, 2013	
	September 30, 2014		September 30, 2013	
	Private	Other	Private	Other
	Equity		Equity	
	(In thousands)			
Fair value, beginning balance	\$27,339	\$4,476	\$26,333	\$1,457
Net unrealized gains included in Accumulated other comprehensive income ⁽¹⁾	265	1,071	1,830	256
Net realized losses included in Other (expense) income, net ⁽²⁾	(7)	(4)	—	—
Purchases	289	—	—	—
Contributions	4,998	121	19	—
Distributions	(2,949)	—	(1,197)	(194)
Fair value, ending balance	\$29,935	\$5,664	\$26,985	\$1,519
	Nine Months Ended		September 30, 2013	
	September 30, 2014		September 30, 2013	
	Private	Other	Private	Other
	Equity		Equity	
	(In thousands)			
Fair value, beginning balance	\$26,885	\$1,810	\$17,879	\$744
Net unrealized (losses) gains included in Accumulated other comprehensive income ⁽¹⁾	(1,370)	3,927	14,441	1,126

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Net realized losses included in Other (expense) income, net ⁽²⁾	(21)	(5)	(11)	(2)
Purchases	3,244		—		—		—	
Contributions	5,955		121		2,221		—	
Distributions	(4,758)	(189)	(7,545)	(349)
Fair value, ending balance	\$29,935		\$5,664		\$26,985		\$1,519	

All unrealized gains (losses) recognized in Accumulated other comprehensive income for our funeral merchandise (1) and service trust investments are attributable to our preneed customers and are offset by a corresponding reclassification in

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Accumulated other comprehensive income to Deferred preneed funeral and cemetery receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral and cemetery receipts held in trust.

All losses recognized in Other (expense) income, net for our funeral merchandise and service trust investments are attributable to our preneed customers and are offset by a corresponding reclassification in Other (expense) income, (2) net to Deferred preneed funeral and cemetery receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral and cemetery receipts held in trust.

Maturity dates of our fixed income securities range from 2014 to 2043. Maturities of fixed income securities, excluding mutual funds, at September 30, 2014 are estimated as follows:

	Fair Value (In thousands)
Due in one year or less	\$ 127,847
Due in one to five years	52,319
Due in five to ten years	37,248
Thereafter	29,811
	\$247,225

Earnings from all our funeral merchandise and service trust investments are recognized in funeral revenues when a service is performed or merchandise is delivered. Fees charged by our wholly-owned registered investment advisor are also included in current revenues. In addition, we are entitled to retain, in certain jurisdictions, a portion of collected customer payments when a customer cancels a preneed contract; these amounts are also recognized in current revenues in the period in which they are earned. Recognized trust fund income (realized and unrealized) related to these trust investments was \$15.1 million and \$11.4 million for the three months ended September 30, 2014 and 2013, respectively. Recognized trust fund income (realized and unrealized) related to these trust investments was \$47.6 million and \$35.7 million for the nine months ended September 30, 2014 and 2013, respectively.

We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. Impairment charges resulting from this assessment are recognized as investment losses in Other (expense) income, net and a decrease to Preneed funeral receivables, net and trust investments. These investment losses, if any, are offset by the corresponding reclassification in Other (expense) income, net, which reduces Deferred preneed funeral receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral receipts held in trust. For the three months ended September 30, 2014 and 2013, we recorded a \$41.2 million and a \$0.2 million impairment charge, respectively, for other-than-temporary declines in fair value related to unrealized losses on certain investments. For the nine months ended September 30, 2014 and 2013, we recorded a \$41.6 million and a \$0.8 million impairment charge, respectively, for other-than-temporary declines in fair value related to unrealized losses on certain investments. The third quarter 2014 impairment charges were recorded in anticipation of a strategic change in the management of our trust assets requiring the liquidation of a majority of our US trust assets subsequent to quarter end. This change does not impact our asset allocation, but does change the underlying legal structure housing the assets. These impairment charges reflect the unrealized loss positions on these liquidated assets as of September 30, 2014. We have determined that the remaining unrealized losses in our funeral merchandise and service trust investments are considered temporary in nature, as the unrealized losses were due to temporary fluctuations in interest rates and equity prices. The investments are diversified across multiple industry segments using a balanced allocation strategy to minimize long-term risk. We believe that none of the remaining securities are other-than-temporarily impaired based on our analysis of the investments. Our analysis included a review of the portfolio holdings and discussions with the individual money managers as to the sector exposures, credit ratings, and the severity and duration of the unrealized losses. Our funeral merchandise and service trust investment unrealized losses, their associated fair values, and the duration of unrealized losses as of September 30, 2014 and December 31, 2013, respectively, are shown in the following tables:

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	September 30, 2014				Total	
	In Loss Position Less Than 12 Months		In Loss Position Greater Than 12 Months			
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Fixed income securities:						
U.S. Treasury	\$10,030	\$(53)	\$—	\$—	\$10,030	\$(53)
Canadian government	4,216	(61)	18,977	(861)	23,193	(922)
Corporate	9,001	(126)	—	—	9,001	(126)
Residential mortgage-backed	167	(2)	412	(19)	579	(21)
Equity securities:						
Common stock:						
United States	88,625	(126)	—	—	88,625	(126)
Canada	1,580	(252)	1,678	(30)	3,258	(282)
Other international	7,964	(2)	—	—	7,964	(2)
Mutual funds:						
Equity	151,716	(586)	—	—	151,716	(586)
Fixed income	102,035	(1,125)	—	—	102,035	(1,125)
Private equity	—	—	15,501	(7,112)	15,501	(7,112)
Other	714	(22)	—	—	714	(22)
Total temporarily impaired securities	\$376,048	\$(2,355)	\$36,568	\$(8,022)	\$412,616	\$(10,377)
	December 31, 2013					
	In Loss Position Less Than 12 Months		In Loss Position Greater Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Fixed income securities:						
U.S. Treasury	\$29,092	\$(3,595)	\$19,708	\$(2,004)	\$48,800	\$(5,599)
Canadian government	9,546	(120)	18,981	(993)	28,527	(1,113)
Corporate	21,568	(346)	5,668	(345)	27,236	(691)
Residential mortgage-backed	1,401	(25)	175	(8)	1,576	(33)
Asset-backed	3,321	(10)	—	—	3,321	(10)
Equity securities:						
Preferred stock	14,223	(235)	—	—	14,223	(235)
Common stock:						
United States	47,190	(2,153)	3,386	(775)	50,576	(2,928)
Canada	2,441	(576)	1,992	(641)	4,433	(1,217)
Other international	3,443	(138)	376	(60)	3,819	(198)
Mutual funds:						
Equity	16,430	(337)	12,686	(1,966)	29,116	(2,303)
Fixed income	145,845	(4,984)	38,922	(14,593)	184,767	(19,577)
Private equity	—	—	13,002	(8,726)	13,002	(8,726)
Other	—	—	527	(33)	527	(33)
Total temporarily impaired securities	\$294,500	\$(12,519)	\$115,423	\$(30,144)	\$409,923	\$(42,663)

5. Preneed Cemetery Activities

Preneed cemetery receivables, net and trust investments represent trust investments, including investment earnings and customer receivables, net of unearned finance charges, for contracts sold in advance of when the property interment rights, merchandise, or services are needed. Our cemetery merchandise and service trusts are variable interest entities as defined in the Consolidation Topic of the ASC. In accordance with this guidance, we have determined that we are the primary beneficiary of these trusts, as we absorb a majority of the losses and returns associated with these trusts. The trust investments detailed in Notes 4 and 6 are also accounted for as variable interest entities. When we receive payments from the customer, we deposit the amount required by law into the trust and reclassify the corresponding amount from Deferred preneed cemetery revenues into Deferred

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preneed funeral and cemetery receipts held in trust. Amounts are withdrawn from the trusts when the contract obligations are performed. Cash flows from preneed cemetery contracts are presented as operating cash flows in our unaudited condensed consolidated statement of cash flows.

Preneed cemetery receivables, net and trust investments are reduced by the trust investment earnings (realized and unrealized) that we have been allowed to withdraw in certain states prior to maturity. These earnings are recorded in Deferred preneed cemetery revenues until the service is performed or the merchandise is delivered.

The table below sets forth certain investment-related activities associated with our preneed cemetery merchandise and service trusts:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
	(In thousands)			
Deposits	\$34,018	\$27,407	\$95,421	\$81,019
Withdrawals	33,669	26,542	96,238	89,881
Purchases of available-for-sale securities	247,853	98,803	458,176	395,200
Sales of available-for-sale securities	285,411	73,171	481,258	407,503
Realized gains from sales of available-for-sale securities	40,635	19,965	86,822	66,284
Realized losses from sales of available-for-sale securities	(4,439)	(3,454)	(10,564)	(12,509)

The components of Preneed cemetery receivables, net and trust investments in our unaudited condensed consolidated balance sheet at September 30, 2014 and December 31, 2013 are as follows:

	September 30, 2014	December 31, 2013
	(In thousands)	
Trust investments, at fair value	\$1,478,069	\$1,532,875
Cash and cash equivalents	127,576	138,459
Assets associated with businesses held for sale	(28,179)	(106,815)
Insurance-backed fixed income securities	13	4
Trust investments	1,577,479	1,564,523
Receivables from customers	856,330	798,365
Unearned finance charges	(32,277)	(29,604)
	2,401,532	2,333,284
Allowance for cancellation	(64,140)	(55,922)
Preneed cemetery receivables, net and trust investments	\$2,337,392	\$2,277,362

Our cemetery merchandise and service trust investments are recorded at fair value. The costs and fair values at September 30, 2014 and December 31, 2013 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair value represents the market value of the underlying securities held by the common trust funds, mutual funds at published values, and the estimated fair value of private equity investments.

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	September 30, 2014				
	Fair Value	Cost	Unrealized	Unrealized	Fair
	Hierarchy		Gains	Losses	Value
	Level				
			(In thousands)		
Fixed income securities:					
U.S. Treasury	2	\$101,400	\$1,617	\$(2)	\$103,015
Canadian government	2	17,719	217	(157)	17,779
Corporate	2	41,849	5,010	(167)	46,692
Residential mortgage-backed					